INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute involved	2
Statement	3
Argument	9
Conclusion	12

CITATIONS

Cases:	
Dandridge v. *Williams*, 397 U.S. 471	10
Ferguson v. *Skrupa*, 372 U.S. 726	10
Fiduciary Counsel, Inc. v. *W. Willard Wirtz, Secretary of Labor*, 389 U.S. 1005	5, 9
Williamson v. *Lee Optical Co.*, 348 U.S. 483	10
Statutes and regulations:	
15 U.S.C. 80b–4	8
Welfare and Pension Plans Disclosure Act, 72 Stat. 997, Section 13, as added, 76 Stat. 39, 29th S.C. 308d	2
Section 13(a)	2, 5, 7
Section 13(b)	5
Section 13(e)	3, 7
17 C.F.R. 275.206(4)–2(a)	8
Notice of Proposed Rule Making, 33 Fed. Reg. 9346, 9556	6

422-267—71

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 1472

FIDUCIARY COUNSEL, INC., PETITIONER

v.

JAMES D. HODGSON, SECRETARY OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The judgment of the court of appeals and the order of the district court (Pet. App. 1a, 2a) are unreported. The administrative decision of the Secretary of Labor (Pet. App. 4a–12a) is reported in part at 34 Fed. Reg. 1051. This Court's denial of petitioner's prior petition for certiorari (Pet. App. 22a) is reported at 389 U.S. 1005, *sub nom. Fiduciary Counsel, Inc.* v. *W. Willard Wirtz, Secretary of Labor.* The prior court of appeals opinion (Pet. App. 16a–22a) is reported at 383 F. 2d 203, and the prior district court judgment is unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 14, 1970. The petition for a writ of certiorari was filed on March 15, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the courts below correctly sustained the determination by the Secretary of Labor that the safeguards applicable to registered investment advisers were far weaker than those applicable to federally regulated banks, and hence did not warrant a class exemption for investment advisers from the bonding requirement of the Welfare and Pension Plans Disclosure Act, 29 U.S.C. 301 *et seq.*

STATUTE INVOLVED

Section 13 of the Welfare and Pension Plans Disclosure Act, 72 Stat. 997, as added, 76 Stat. 39, 29 U.S.C. 308d, provides in pertinent part as follows:

> (a) Every administrator, officer, and employee of any employee welfare benefit plan or of any employee pension benefit plan subject to this chapter who handles funds or other property of such plan shall be bonded as herein provided; except that, where such plan is one under which the only assets from which benefits are paid are the general assets of a union or of an employer, the administrator, officers and employees of such plan shall be exempt from the bonding requirements of this section. * * * Such bond shall provide protection to the plan against loss by reason of acts of

fraud or dishonesty on the part of such administrator, officer, or employee, directly or through connivance with others. Any bond shall have as surety thereon a corporate surety company which is an acceptable surety on Federal bonds under authority granted by the Secretary of the Treasury pursuant to sections 6–13 of Title 6. Any bond shall be in a form or of a type approved by the Secretary, including individual bonds or schedule or blanket forms of bonds which cover a group or class.

* * * * *

(e) The Secretary shall from time to time issue such regulations as may be necessary to carry out the provisions of this section. When, in the opinion of the Secretary, the administrator of a plan offers adequate evidence of the financial responsibility of the plan, or that other bonding arrangements would provide adequate protection of the beneficiaries and participants, he may exempt such plan from the requirements of this section.

STATEMENT

Petitioner, Fiduciary Counsel, Inc., is a New York corporation registered with the Securities and Exchange Commission as an investment adviser, and engaged in the business of providing counseling to clients on a fee basis with respect to the purchase and sale of securities. Since October 1962, petitioner has been acting as investment counselor to two pension trusts set up by the Parker Pen Company for the purpose of providing retirement, death and disability benefits for certain of its employees. All the funds of

the trust are contributed by Parker and segregated from its general assets (Pet. 3, 4). Both trust instruments provide that the company shall have "no right, title or interest in the contributions made by it under the Plan" and that no part of the retirement fund or its income shall revert to the company (Stipulated Facts, App. A, B).

The trustee of each plan is presently a Wisconsin bank (Pet. 3). While the trustee is given full power to make sales and investments, the trust instruments reserve to the employer "a right to retain an investment advisor who can give to the trustee binding directions as to investment" (Pet. App. 17a). Pursuant to this provision the company named petitioner as counsel to the trust. It was "mandatory" that the trustee bank "make every sale and investment which [petitioner] direct[ed] it to make, and from time to time since October 2, 1962, [petitioner] has directed the trustee Bank, pursuant to this provision, to make sales and investments which the trustee Bank has made" (Stipulated Facts, ¶ 8).

Parker Pen filed reports covering the two plans with the Secretary of Labor, as required by the reporting and disclosure provisions of the Welfare and Pension Plans Disclosure Act. On April 25, 1963, the Secretary advised petitioner that it was subject to the bonding requirement of the Act (Stipulated Facts, ¶¶ 12, 13). Petitioner then brought an action against the Secretary to obtain a declaratory judgment either that the bonding requirement of the Act did not apply to it, or that, if applicable, the Secretary was arbi-

trary and capricious in not granting it an exemption (Pet. App. 17a). The Secretary counterclaimed for an injunction requiring petitioner to bond its employees against dishonesty losses in the handling of funds of the two Parker pension plans.[1] On cross motions for summary judgment, the district court granted judgment for the Secretary, agreeing that the bonding requirement of Section 308d(a) was applicable to petitioner (Pet. App. 12a–15a).

The court of appeals (Pet. App. 16a–22a) affirmed the ruling that petitioner is subject to the bonding provisions of the Act, expressly noting "the Congressional concerns about the jeopardy in which pension assets had been placed by the dissipation which can flow from either direct thievery or dishonest investment * * *" (Pet. App. 18a). It remanded the case to the district court, however, for a determination of the reasonableness of the Secretary's regulation which exempted state and federally regulated banks, but not registered investment advisers like petitioner, from the bonding requirements. Petitioner then filed a petition for a writ of certiorari (No. 681, O.T., 1967) in which it contended that it was not subject to the bonding requirements of the Act. This Court denied that petition. *Fiduciary Counsel, Inc.* v. *W. Willard Wirtz, Secretary of Labor,* 389 U.S. 1005 (Pet. App. 22a).

[1] Section 13(b) of the Act (29 U.S.C. 308d(b)) makes it "unlawful for any administrator, officer, or employee" to whom the bonding requirement of Section 13(a) applies "to receive, handle, disburse, or otherwise exercise custody or control of any of the funds or other property of any employee welfare benefit plan or employee pension benefit plan, without being bonded as required by subsection (a) * * *."

The decision of the court of appeals prompted the Secretary to reevaluate the regulatory provisions for exemptions from the bonding requirements. The Secretary announced his intention to hold hearings on this subject and moved for a stay of the remand proceedings in the district court pending the outcome of the hearing. The stay was granted; the Secretary then published a Notice of Proposed Rule Making, 33 Fed. Reg. 9346, 9556. Written and oral communications, views and argument were invited from interested parties on the questions whether an exemption should be granted to (1) banks and trust companies subject to state regulation, (2) banks and trust companies subject to federal regulation, or (3) investment advisers registered with and regulated by the Securities and Exchange Commission (Pet. App. 4a–5a).

The evidence adduced at the rule-making hearing showed that the court of appeals' apprehensions about the unevenness of state regulation of banks were well founded (Pet. App. 8a). The Secretary concluded that state regulated banks did not "offer adequate evidence of 'financial responsibility' of the plans they service and [had no] 'other bonding arrangements' which provides adequate protection for the beneficiaries and participants of the plans they service" (Pet. App. 10a–11a). Accordingly, the Secretary denied a class exemption to such banks.

The Secretary also found that the evidence adduced at the hearing warranted an exemption for federally-regulated banks but did not ~~warrant~~ warrant a similar exemption for investment advisers. This evidence showed

that the standards and safeguards imposed on investment advisers differed considerably from those imposed on federally-regulated banks (Pet. App. 5a–7a, 9a–10a). While the latter are generally required by the Federal Deposit Insurance Corporation ("F.D.I.C.") to procure fidelity bonding in amounts determined according to asset strength and other financial indicia, no bonding requirement whatever is imposed on investment advisers by the Securities and Exchange Commission (Pet. App. 6a–7a, 9a). Moreover, all federally-regulated banks are required to meet uniform capital and reserve requirements, and the F.D.I.C., the Comptroller of the Currency, and the Federal Reserve Board all oversee these banks to insure the maintenance of high standards of financial soundness; deficiencies must be corrected on pain of loss of charter membership. No such supervision is undertaken by the S.E.C. for investment advisers, and for this reason the S.E.C. has explicitly recommended to the Secretary of Labor that no bonding exemption be granted investment advisers (Appellee's Appendix 96–97).[2] And finally, while federally-regulated banks

[2] The Appellee's Appendix contains relevant excerpts of the Secretary's rule-making hearing and is part of the record lodged with this Court. It reflects (pp. 96–97) that the S.E.C., in its submission to the hearing examiner, stated that "the Commission would not recommend that registered investment advisers, as a class, be granted an exemption from the bonding requirements of Section 308d(a) of the Welfare and Pension Plans Disclosure Act pursuant to the authority contained in Section 308d(e) of that Act." The S.E.C. noted that while an investment adviser is subject to the anti-fraud provisions of the Investment Advisors Act of 1940, "no financial responsibility

are examined frequently by a corps of trained examiners, and trust departments receive special attention, the S.E.C. inspections of investment advisers are less comprehensive and much less frequent (Pet. App. 7a, 9a–10a).[3]

Following the Secretary's decision to deny an exemption to the investment advisers, cross-motions for summary judgment based upon the administrative record were filed in the district court. The district court denied petitioner's motion and granted the Secretary's motion for summary judgment (Pet. App. 2a). The court of appeals affirmed *per curiam* (Pet. App. 1a).

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requirements are imposed upon investment advisers as a condition of registration or the operation of their business." Certain safeguards are imposed if the adviser "has custody or possession of funds or securities of clients," but since most investment advisers do not take custody of a client's funds or securities, this anti-fraud protection, in the words of the S.E.C., "has a very narrow compass, being limited to a very special type of investment adviser." Hence, the Commission did not believe that investment advisers should receive a bonding exemption.

[3] National banks under federal regulation are examined by the Comptroller's Office at least three times every two years, and trust departments are examined annually on a surprise basis. State banks under federal regulation are examined at least once a year (Pet. App. 7a).

The S.E.C. conducts one annual surprise investigation in the rare case where the investment adviser has custody of a client's funds or securities. 17 C.F.R. 275.206(4)–2(a). And although the S.E.C. is authorized to conduct periodic inspection of investment advisers, 15 U.S.C. 80b–4, these inspections are infrequent. The evidence at the hearing was that about 250 inspections were made annually, although some 1,600 advisers are registered with the Commission. Petitioner testified that it had been inspected once in the past three years (Appellee's Appendix 103–104, 109).

ARGUMENT

1. The issue whether petitioner is subject to the requirements of the Welfare and Pension Plans Disclosure Act was decided adversely to petitioner by the district court in the initial proceeding (Pet. App. 12a–15a); the court of appeals affirmed (Pet. App. 16a–22a) and this Court denied certiorari on that issue. *Fiduciary Counsel, Inc.* v. *W. Willard Wirtz, Secretary of Labor,* 389 U.S. 1005. There is nothing in the present petition to warrant further consideration of that issue by this Court. See our Brief in Opposition in No. 681, O.T., 1967.

2. The Secretary of Labor's decision denying investment advisers a class exemption from the bonding requirements of the Welfare and Pension Plans Disclosure Act was a proper exercise of his statutory authority. The Secretary, following a full administrative hearing, concluded (Pet. App. 11a) that:

> 3. Investment advisers registered with and regulated by the Securities and Exchange Commission pursuant to the Investment Advisers Act of 1940 and subject to 29 CFR 464 should not as a class be granted an exemption from the WPPDA bonding requirement since the Securities and Exchange Commission does not impose or supervise a bonding requirement with respect to investment advisers, because the Securities and Exchange Commission does not impose or supervise any requirement with respect to investment advisers, pertaining to the maintenance of a sound financial condition, and because the periodic inspections conducted by the Securities and Exchange Commission are not

> conducted frequently enough to satisfactorily insure the implementation of the fiscal safeguards imposed on investment advisers by law. It is concluded that investment advisers registered with and regulated by the Securities and Exchange Commission as a class do not, within the contemplation of section 13(e), WPPDA, offer adequate evidence of "financial responsibility" of the plans they service and do not have "other bonding arrangements" which provide adequate protection for the beneficiaries and participants of the plans they service. This conclusion shall not prejudice the right of any investment adviser to petition for a bonding exemption on an individual basis.

Both courts below upheld this determination, and their decisions are not in conflict with the decisions of any other court.

In essence, the only new question presented in the petition is whether the amended regulation promulgated by the Secretary, denying an exemption, is arbitrary and unauthorized by the Act. This Court has recently reiterated the strictly limited role of the courts in reviewing governmental regulation of economic institutions. *Dandridge* v. *Williams,* 397 U.S. 471, 484–485. Classifications and exemptions in economic regulation will be struck down only if they embody an "invidious discrimination." *Ferguson* v. *Skrupa,* 372 U.S. 726, 732; *Williamson* v. *Lee Optical Co.,* 348 U.S. 483, 489.

Nothing approaching an "invidious discrimination" is present here. The Secretary has received persuasive

evidence that all federally-regulated banks, by virtue of the regulatory requirements imposed on them, do meet the statutory standards for exemptions. He has likewise received evidence that state-regulated banks and investment advisers do not uniformly meet those standards, and has accordingly denied them a class exemption. Both lower courts reviewed the voluminous evidence on this point and concluded that the Secretary had not improperly denied investment advisers a class exemption. There is thus no support in this record for petitioner's sweeping assertion that it is the victim of "patently unequal treatment" (Pet. 10).

Petitioner suggests that, since it had no physical control of the funds and was subject to S.E.C. regulation and removal by the Parker Pen Company on thirty days' notice, it posed a negligible threat of loss (Pet. 9). These arguments more appropriately go to the question whether investment advisers are subject to the Act, rather than to whether they should be exempted from the statutory bonding requirement. In any event, even in the absence of custody, the Secretary could reasonably find that there remain opportunities for wrongdoing. At the hearing, it was conceded that a risk of loss did remain "in some sort of misdirection of investments" (Appellee's Appendix 99). The fact that the plan's sponsor may replace the adviser on thirty-days' notice does not reduce this risk. The S.E.C. has recommended against granting an exemption to investment advisers based on its regulation, for it imposes neither bonding nor financial responsibility requirements on advisers.

Congress has attempted to assure that, by virtue of a bond or the sheer weight of an institution's assets, any loss resulting from a breach of fiduciary duty will be repaired. It accordingly required evidence of adequate bonding or financial responsibility to protect the beneficiaries. Petitioner argues that investment advisers should gain an exemption based on neither, but because the risk of loss in its view is negligible. That argument was properly rejected by Congress, the Secretary and the courts below. Further consideration of it by this Court is not warranted.

CONCLUSION

For the reasons stated above, and for the reasons set forth in our prior brief in opposition, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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